

AMENDING THE BANKRUPTCY ACT TO FACILITATE THE FINANCING OF SAFETY LOANS IN RAILROAD REORGAN- IZATION CASES

JULY 30, 1951.—Committed to the Committee of the Whole House on the State of
the Union and ordered to be printed

Mr. HILLINGS, from the Committee on the Judiciary, submitted the
following

REPORT

[To accompany H. R. 4693]

The Committee on the Judiciary, to whom was referred the bill (H. R. 4693) to amend section 77, subsection (c) (3), of the Bankruptcy Act, as amended, having considered the same, report favorably thereon without amendment and recommend that the bill do pass.

PURPOSE

The purpose of this bill is to amend subsection (c) (3) of section 77 of the Bankruptcy Act so as to remove any doubts as to the power of a bankruptcy court to permit the financing of safety equipment by a railroad in reorganization by directing that certificates issued for such purpose shall have priority over existing obligations and receivership charges, including duties, debts, or taxes in favor of a State or its subdivisions or instrumentalities, and to such parity with all or any portion of the other costs or expenses of administration or operation as in the particular case the judge may find equitable.

The second section of the bill specifies that the legislation shall take effect immediately upon the date of its approval and makes it applicable to any authorization given by the judge, regardless of whether such authorization shall have been given before or shall be given after such date. This section further provides that neither the enactment of the measure nor anything contained therein shall be construed to imply that a judge is not now vested with the power the act expressly grants to him.

HISTORY

An earlier bill (H. R. 3751) was introduced to accomplish the purposes just stated. In addition, however, it provided that trustee's

certificates to provide funds to pay for the acquisition, assembly, or installation of safety equipment or materials related thereto, or to reimburse the trustee for funds so expended, could be given priority, not only over existing obligations and receivership charges (as provided in the present subsection (c) (3)) but over all or any portion of the costs or expenses of administration or operation, including duties, debts, or taxes in favor of a State or its subdivisions or instrumentalities.

In commenting on the provisions of H. R. 3751, the Legislative Committee of the Interstate Commerce Commission questioned the desirability of extending such priority over "all or any portion of the costs, or expenses of administration or operation," since the interpretation would likely be to give the certificates superiority over payments for wages, supplies, and other expenses necessary to the operation of the railroad. The committee is advised that the author of the measure did not intend the lien to take precedence over necessary operating and administration expenses. Accordingly, the proposed amendment was reintroduced as H. R. 4693, which bill has the approval of your committee.

Hearings were conducted by Subcommittee No. 4 of this committee, at which time interested persons presented testimony as to the need for and the desirability of enacting legislation of this type.

GENERAL STATEMENT

This proposed amendment to the Bankruptcy Act is general legislation but is designed to cover a particular situation; namely, the Long Island Railroad reorganization proceedings. Two serious wrecks occurring within 1 year made it essential that steps be taken to insure safer operation of the railroad. After an investigation, the Interstate Commerce Commission recommended the installation of an automatic speed-control system. Other public bodies having responsibility in the matter, and experts retained by the trustee came to the same conclusion. The estimated cost of the safety installations agreed upon is approximately \$6,000,000.

As the railroad was in receivership, the problem of financing the safety program was a serious one. This was especially true in view of the numerous death and personal-injury claims arising out of the wreck. The committee has been furnished the following information relative to the efforts of the trustee to borrow the requisite funds for the purchase and installation of the safety equipment:

The trustee was able, after lengthy negotiations with private and public lending institutions, to obtain an offer from a group of banks to lend the required \$6,000,000. The loan was to be evidenced by certificates having priority in payment over all obligations of the debtor existing at the date of the institution of the reorganization proceedings, as well as over State and local taxes accruing during the proceedings. The priority over taxes was considered an indispensable condition of the offer because of the financial condition of the railroad. No lender appeared who was willing to extend credit without such a priority. This offer was accepted by the trustee with the approval of the reorganization court. The obligation of the banks to make loans pursuant to their offer is subject to certain conditions, including receipt by them of an opinion of eminent counsel selected by them that the certificates can validly be given priority over past and future taxes. Counsel selected by the banks have indicated that, after preliminary study, they have doubts regarding the validity of the subordination of tax claims in the manner contemplated by the offer of the banks. Accordingly, the counsel are not prepared to give the requisite opinion at the present time.

There was an expression of opinion that existing law is sufficient for these purposes, but this express language was necessary to remove any doubt of interpretation.

Attached hereto and made a part of this report are the following letters from the Interstate Commerce Commission and the Department of Justice regarding this proposed legislation:

INTERSTATE COMMERCE COMMISSION,
Washington, D. C., May 28, 1951.

HON. EMANUEL CELLER,
*Chairman, Committee on the Judiciary,
House of Representatives, Washington, D. C.*

MY DEAR CHAIRMAN CELLER: Your letter of April 26, 1951, addressed to the Chairman of the Commission and requesting an expression of views on H. R. 3751, introduced by Congressman Leonard W. Hall, to amend section 77, subsection (c) (3), of the Bankruptcy Act, as amended, has been referred to our Legislative Committee. After careful consideration by that Committee, I am authorized to submit the following comments in its behalf:

Subsection (c) (3) now empowers judges in proceedings under section 77 to authorize trustees "to issue certificates for cash, property, or other consideration approved by the judge, for such lawful purposes and upon such terms and conditions and with such security and such priority in payments over existing obligations, secured or unsecured, or receivership charges, as might in an equity receivership be lawful." We understand that the trustee of the Long Island Rail Road desires to issue such certificates in the amount of \$6,000,000 to finance the acquisition of safety equipment designed to prevent accidents such as those which occurred on this railroad some time ago, and that securing such a loan will be facilitated if the certificates therefor can be given priority over tax liens and taxes levied on the railroad property in the future.

Accordingly it is proposed in H. R. 3751 to add a sentence to subsection (c) (3) which would permit such priority "where such certificates are authorized to provide funds to pay for the acquisition, assembly, or installation of safety equipment or materials related thereto, or for the purpose of reimbursing the trustee or trustees for funds so expended." In our opinion this objective is desirable. However, the sentence proposed to be added provides for priority not only over taxes but also over "all or any portion of the costs or expenses of administration or operation." This apparently would make the obligation of the certificates superior to payments for wages, supplies, and other expenses necessary to the operation of the railroad, and such a broad priority seems clearly objectionable. We therefore recommend that the bill be amended by deleting from lines 16 and 17 of page 2 the words "and all or any portion of the costs or expenses of administration or operation" and from line 22 on the same page the words "costs or expenses."

In lines 10 and 11 of page 1 of the bill there is a reference to section 20 (a) of the Interstate Commerce Act. This repeats an inadvertent error of draftsmanship which occurred at the time of original enactment of subsection (c) (3). The reference should have been to section 20a. We therefore recommend that "20 (a)" in line 11 be changed to "20a." We point out also that in line 6 of page 2 there is no comma between the words "charges" and "as", contrary to the punctuation of the present subsection (c) (3).

If the amendments above suggested are made, we recommend that H. R. 3751 pass.

Respectfully submitted.

WALTER M. W. SPLAWN,
Chairman, Legislative Committee.
CHARLES D. MAHAFFIE.
JOHN L. ROGERS.

DEPARTMENT OF JUSTICE,
OFFICE OF THE DEPUTY GENERAL,
Washington, June 19, 1951.

Hon. EMANUEL CELLER,
Chairman, Committee on the Judiciary,
House of Representatives, Washington, D. C.

MY DEAR MR. CHAIRMAN: This is in response to your request for the views of the Department of Justice concerning the bill (H. R. 3751), to amend section 77, subsection (c) (3), of the Bankruptcy Act, as amended.

Section 77, subsection (c) (3) of the Bankruptcy Act, as amended (11 U. S. C. 205 (c) (3)), now provides that the judge, for cause shown, upon the giving of the required notice, and with the approval of the Interstate Commerce Commission, may authorize the trustee in bankruptcy to issue certificates for cash, property, or other consideration approved by the judge, for such lawful purposes and upon such terms and conditions and with such security and such priority in payments over existing obligations, secured or unsecured, or receivership charges as might in an equity receivership be lawful.

The first part of section 1 of the bill substantially follows the wording of the present subsection (c) (3), but new provisions are added authorizing the judge to direct that any certificates issued to provide funds for the acquisition, assembly, or installation of safety equipment or related materials, or for the purpose of reimbursing the trustee for funds so expended shall have such lien on the property of the debtor and be entitled to such priority in payment over existing obligations, secured or unsecured, receivership charges, costs or expenses of administration or operation, including debts or taxes payable to any State or to any subdivision or instrumentality thereof as the judge may find equitable regardless of whether such obligations are secured by liens on real and personal property or whether they become payable before or after the issuance of such certificates.

The scope of the court's power to provide for priorities under the present subsection (c) (3) is limited by the phrase, "with * * * such priority in payments over existing obligations, secured or unsecured, or receivership charges as might in an equity receivership be lawful." Under this provision express authority to grant priority to the certificates is given only with reference to existing obligations and receivership charges. The proposed new portion, which authorizes the granting of priority for certificates that may be issued to pay for safety equipment, extends the priority for such certificates over any or all of the expenses of administration or operation, including duties, debts, or taxes payable to a State, its subdivisions or instrumentalities.

There is some question as to the need for this proposed extension of the court's power to authorize a priority in this narrow field. This is because the purchasing of necessary safety equipment is an expense of operation that must be met if a railroad is to be kept in operation—and railroads must be kept in operation. The courts therefore recognize that in railroad receivership cases operating expenses by implication have the highest priority. In *Reconstruction Finance Corporation v. M. K. Tex. R. Co.* (122 F. (2d) 325 (C. C. A. 8)), the court held that certificates of indebtedness issued by a trustee to the RFC in a railroad-receivership case under a court order making them prior to outstanding mortgages, bonds, and interest and all other obligations of every nature, were nevertheless inferior to the operating expenses. The court said (p. 331):

"The conclusion ought not be indulged unless inexorably compelled by the language of the order and the conditions under which it was made, that the court was intending to fetter and perhaps render wholly impossible, the continued operation of the railroad, by an impotence to make acceptable provisions for necessary future expenses."

The courts probably would take an analogous position in construing the limitation imposed by the present subsection (c) (3) and hold that in spite of the express limitation of priorities to those over existing obligations and receivership charges, certificates given to pay for safety equipment could by implication be given priority over such items as duties, debts, or taxes payable to a State and perhaps over other operating expenses. However, since no court has passed upon the matter, the scope of a court's power to grant priority under the present subsection (c) (3) is uncertain.

The power of the court to grant security and priority to the trustees' certificates is in the present subsection (c) (3) limited by the phrase "as might in an equity receivership be lawful." The corresponding limitation in the proposed new provision of the bill reads, "as in the particular case the judge may find equitable at the time of authorizing the issuance of such certificates." It is believed that

priority of the character provided for in the proposed new provision could be granted under either limitation.

The effect of the bill would be to make certain that in a reorganization proceeding under section 77 of the Bankruptcy Act the judge would have the power to direct that, where certificates are authorized for the special purpose of providing funds for the installation of safety equipment or related materials or for reimbursing the trustee for funds so expended, such certificates shall have priority, not only over existing obligations and receivership charges (as provided in the present subsection (c) (3)), but over all or any portion of the costs or expenses of administration or operation, including duties, debts, or taxes in favor of a State or its subdivisions or instrumentalities.

Section 2 of the bill specifies when the legislation shall take effect and makes it applicable to any authorization of certificates given by the judge before the date of approval of the measure. Section 2 further provides that neither the enactment of the measure nor anything contained therein shall imply that a judge is not now vested with the power the act expressly grants to him.

The words "or during proceedings under this section or before," in line 1 of page 3 of the bill would appear to be surplusage and it is suggested that they be deleted.

Whether the bill should be enacted involves a question of policy concerning which this Department prefers not to make any recommendation.

The Director of the Bureau of the Budget has advised that there is no objection to the submission of this report.

Yours sincerely,

PEYTON FORD,
Deputy Attorney General.

CHANGES IN EXISTING LAW

In compliance with clause 2a of rule XIII of the House of Representatives, there is printed below in roman existing law in which no change is proposed, with matter proposed to be stricken out enclosed in black brackets, and new matter proposed to be added shown in italic:

SECTION 77, SUBSECTION (c) (3) OF THE BANKRUPTCY ACT (49 STAT. 911)

"(3) The judge may, upon not less than fifteen days' notice published in such manner and in such newspapers as the judge may in his discretion determine, which notice so determined shall be sufficient, for cause shown, and with the approval of the Commission, in accordance with section [20 (a)] 20a of the Interstate Commerce Act, as now or hereafter amended, authorize the trustee or trustees to issue certificates for cash, property, or other consideration approved by the judge, for such lawful purposes and upon such terms and conditions and with such security and such priority in payments over existing obligations, secured or unsecured, or receivership charges, as might in an equity receivership be lawful. *Where such certificates are authorized to provide funds to pay for the acquisition, assembly or installation of safety equipment or materials related thereto, or for the purpose of reimbursing the trustee or trustees for funds so expended, the judge may direct (without limitation of his power to make such direction in the absence of this provision) that the certificates shall have such lien on the property of the debtor and shall be entitled to such priority in payments over existing obligations, secured or unsecured, and receivership charges and present or future duties, debts, or taxes or other obligations in favor of or payable to any State or any subdivision, agency or instrumentality thereof and interest or penalties, and to such parity with all or any portion of the other costs or expenses of administration or operation as in the particular case the judge may find equitable at the time of authorizing the issuance of such certificates, regardless of whether such obligations, charges, costs or expenses, duties, debts, or taxes constitute or are secured by liens on real or personal property or shall have become payable before or after the issuance of such certificates.*"

SEC. 2. This Act shall take effect immediately upon the date of its approval and shall apply to any authorization given by the judge, regardless of whether such authorization shall have been given before or shall be given after such date. Neither the enactment of this Act nor anything herein contained shall be construed as implying that, prior to the date of approval of this Act, the judge was not vested with the power which is expressly granted to him by this Act.

